Federal Accounting Standards Advisory Board

September 7, 2006

TO: Members of FASAB

FROM: Penny Wardlow, Consultant

THROUGH: Wendy Comes, Executive Director

SUBJECT: **Conceptual Framework: Elements.**
Summary of Responses to Exposure Draft—TAB B

NOTE: FASAB staff prepares memos and other materials to facilitate discussion of issues at Board meetings. This material is presented for discussion purposes only; it is not intended to reflect authoritative views of the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

This memo presents a summary of the responses to the Board's exposure draft (ED) of a proposed concepts statement, *Definition and Recognition of Elements of Accrual-Basis Financial Statements,* which was released on June 5, 2006.

NUMBER AND CATEGORIES OF RESPONDENTS AND USABLE RESPONSES

The FASAB has received 40 responses to the ED. The responses have been provided to Board members, numbered 1 through 40, and have been grouped into the following categories:

Federal Preparers	13	Nos. 7, 8, 9, 12, 18, 19, 20, 23, 28, 29, 32, 33, and 37
Federal Auditors	12	Nos. 2, 6, 10, 13, 14, 16, 21, 25, 27, 30, 34, and 35
Federal Other	1	No. 36
Non-federal Auditor	1	No. 38
Non-federal Other	13	Nos. 1, 3, 4, 5, 11, 15, 17, 22, 24, 26, 31, 39, and 40.
Total received	40	

"Preparers" include financial statement preparers and financial managers. "Other" comprises users of financial information broadly defined, including citizen/taxpayers, researchers, international organizations, professional societies, and a standard-setting organization.

This summary includes 31 of the 40 responses. The following responses are excluded because they do not answer any of the questions or comment on any of the issues in the ED.

- No. 2 (from a Federal Auditor) and No. 12 (from a Federal Preparer) only acknowledge receipt of the ED.
- No. 3, from a non-federal international entity, refers only to the desirability, in their view, of convergence with IPSASB's future project to develop a conceptual framework.
- Nos. 4 and 5, from individual citizens, support reporting by the federal government of the liabilities it has incurred but provide no other comments.
- No. 15, from a non-federal research organization, refers only to potential long-term liabilities for Social Security and Medicare programs (i.e., issues addressed in FASAB's Social Insurance project).
- No. 17, from a non-federal international entity, describes its own activities and the views of other countries on accounting for social obligations. Nevertheless, there is a comment relevant to Question 3a) and that comment is included in the responses to that question.
- No. 34, from a Federal Auditor, agrees with the Board's approach to developing a conceptual framework but does not comment on the ED. It requests clarification of two standards issues.
- No. 36, from a federal research entity, discusses convergence of international accounting standards and issues related to the System of National Accounts.

After these eliminations, the breakdown of respondents is as follows:

Federal Preparers	12	Nos. 7, 8, 9, 18, 19, 20, 23, 28, 29, 32, 33, and 37
Federal Auditors	10	Nos. 6, 10, 13, 14, 16, 21, 25, 27, 30, and 35
Federal Other	0	
Non-federal Auditor	1	No. 38
Non-federal Other	8	Nos. 1, 11, 22, 24, 26, 31, 39, and 40
Total	31	

As shown, the responses from the Federal community are evenly divided between preparers and auditors.

Most of the 31 usable responses are from an individual on behalf of a department, agency, or other organization. Response Nos. 1 and 24 are personal responses. Nos. 26, 37, and 39 are group or committee responses. No. 37 is a consolidated response for the group and has attached to it 20 "form" letters from members whose views are included in the consolidated response. Staff counts these letters as one with the consolidated response (No. 37); they make the same statements about the FASAB's efforts, the definitions of assets and liabilities, and existence probability, and they refer the reader to the consolidated response for answers to the ED's Questions for Respondents. In contrast, staff counts as separate responses the responses of six of the group members included in No. 37 (Nos. 7, 9, 18, 19, 23, and 32). Although response Nos. 7, 9, and 19 explicitly defer to their responding organization (No. 37) for all of the Questions for Respondents, these respondents and Nos. 18, 23, and 32 sent in separate letters before the consolidated response was finalized. They refer to the consolidated response (a draft at that time), but some of their responses differ in some respects from the consolidated responses in No. 37.

RESPONSES TO QUESTIONS FOR RESPONDENTS

The ED includes ten Questions for Respondents, some of which have more than one part. Questions 3, 8, 9, and 10 cover issues addressed in the Alternative Views, as well as the proposals in the proposed Concepts Statement. A complete set of questions, including the explanatory material for each question, is attached to this summary as Attachment 1. The summary itself contains only the questions.

This summary reports the number of responses in favor of each alternative in each question, to give the Board an idea of the weight of opinion. It also includes examples of the reasons given by the respondents, which the Board requested in the Questions for Respondents. The examples are limited to two or three excerpts for each question (a few more for the most controversial questions) to keep the summary manageable. Staff has attempted to give the Board a view of the range of opinions expressed and the categories of respondents.

In addition to the alternatives (yes or no; agree or disagree; in favor of (1) the proposed Concepts Statement or (2) the Alternative View), the summary reports an "Other" category, which includes "no response" and responses that do not address the question or that comment but do not take a position.

Question 1

a) Should the definitions of assets and liabilities derive from their fundamental or essential characteristics? Please provide the reasons for your position and any alternative approach(s) you would take to define assets and liabilities.
YES (ED POSITION) 29 NO 0 OTHER 2

All responses agree with the ED position on the approach to defining assets and liabilities. Two respondents do not comment on 1a), 1b) or 1c) and a third does not comment on 1b) or 1c).

The following reasons are representative of those given in support of the ED position:

> Yes. Assets and liabilities are basic elements of financial reporting and are the components from which financial statements are developed. They must be defined as an initial portion of constructing an accounting framework. It is appropriate to define these items based on their essential elements. [011—Non-federal Other]

> Yes . . . Basing the definitions of assets and liabilities on their fundamental or essential characteristics provides a sound and clear foundation that can guide agencies in making decisions about classification and in understanding the basis for accounting and reporting standards that the FASAB may develop in the future. [013—Federal Auditor]

b) Should the definitions of net position, revenues, and expenses derive from the definitions of assets and liabilities? Please provide the reasons for your position and any alternative approach(s) you would take to define net position, revenues, and expenses?
YES (ED POSITION) 25 NO 3 OTHER 3

A majority of respondents agree with the ED approach to defining net position, revenues, and expenses. The three respondents who disagree are non-federal entities.

Following are some of the reasons given for supporting the ED position:

> . . . The inflows and outflows of an entity are a direct result of the management of the assets and liabilities as they relate to the production of goods or services of the entity. [028—Federal Preparer]
>
> The definitions of net position, revenues and expenses should derive from the definitions of assets and liabilities as these income statement or statement of activities accounts are used to record the inflow and outflow of assets and the accumulation or relief of liabilities. By deriving these definitions from the balance sheet accounts, it reinforces the relationships between the accounts and financial reporting statements. Also, that is the process used by the Financial Accounting Standards Board (FASB) to define the income statement accounts. When feasible, it is best to remain consistent as to keep a level of transparency between financial reports of various types of organizations and provide ease of understanding for the users of governmental financial statements. [030—Federal Auditor]

Two of the respondents who disagree believe that the definitions of revenues and expenses should be derived from their inherent characteristics, like the definitions of assets and liabilities. They believe their approach is appropriate because it would focus more on flows of resources:

> The definitions of revenue and expenses should also be derived from their fundamental or essential characteristics and not from the definitions of assets and liabilities. The proposed definition of revenue, for example, as "an increase in assets, a decrease in liabilities, or a combination of both,...." appears to confuse the *concept* of revenue, which is an inflow of (or increase in) economic benefits during an accounting period, with the *impact* of such an inflow, which is to increase the stock of assets or reduce the stock of liabilities or a combination of both. Such a reformulation of the definition of revenue and expense in terms of flows would also be consistent with *IPSAS.* [031—Non-federal Other]
>
> We do not agree that the definitions of revenues and expenses should be derived from definitions of assets and liabilities. We believe that the “derived from” approach is inherently flawed because it places emphasis, either intended or unintended, on the statement of financial position over the resource flows statement. . . . [We believe] that these two statements are of equivalent importance and that the elements of neither statement should be defined solely as changes in or residuals of elements in the other statement . . . [040—Non-federal Other (standard setter)]

The third respondent to 1b) believes it generally would be appropriate to derive the definitions of net position, revenues, and expenses from the definitions of assets and liabilities, but is concerned that “the method may not consider all aspects of revenues and expenses in the U.S. federal government environment, such as ‘financing sources’ and ‘imputed costs.’” [011—Non-federal Other]

c) If an item meets the definition of an asset is it an asset even if it is not recognized in the body of a financial statement because, for example, it is not measurable or its amount is not material? Please provide the reasons for your position.
   YES (ED POSITION) 28 NO 0 OTHER 3

All responses agree with the ED position. They do not indicate any difficulty with the conceptual distinction, which is important in the ED, between an item meeting a definition and the item being recognized in the body of the financial statements.

Question 2

a) Are there additional elements of accrual-basis financial statements that should be defined in the Concepts Statement? If so, what are they and what are their essential characteristics? Alternatively, what are they and how would you define them?
   NO (ED POSITION) 11 YES 16 OTHER 4

Nine of the 11 respondents who say NO (ED position) are auditors (8 are federal), whereas 9 of the 16 respondents who think there should be additional elements are federal preparers, 4 are non-federal-other and 2 are federal auditors. In the Other category, 3 respondents do not answer the question; the fourth favors adding elements for budgetary reporting, which is outside the scope of the ED.

The NO responses generally say that the five proposed elements are sufficient for the content of the accrual-basis financial statements. The YES responses generally give examples. Items mentioned by more than one respondent include gains and losses (2 Non-federal Other, 1 Federal Preparer, and 1 Federal Auditor); financing sources or other financing sources (2 Federal Preparers, 2 Non-federal Other); transfers (2 Non-federal Other and 1 Federal Preparer); and unexpended appropriations, cumulative results of operations, appropriations (1 Non-federal Other and 1 Federal Preparer). Two other YES responses suggest allowing for additional elements in the future, as follows:

> Recognizing that FASAB has a project related to social insurance and the applicability of liability definitions, there should be an expectation that additional elements may be contained there. Perhaps this Concepts Statement should refer to these other projects [018—Federal Preparer and 037—Federal Preparer]

b) Do you agree or disagree that there are additional elements that need to be defined? If you agree, what are the essential characteristics of these elements? Please provide examples of the types of transactions that align with these additional elements.
   DISAGREE (ED POSITION) 13 AGREE 14 OTHER 4

Similar to the respondents to 2a) the majority (9) in the DISAGREE group are auditors (the same as for 2a), whereas a slight majority (8) in the AGREE group are federal preparers. The other respondents in the AGREE group are 5 non-federal-other and one federal auditor.

Ten of the respondents who answered NO to 2a) also said NO to 2b). Similarly, 13 of those who answered YES to 2a) also answered YES to 2b). Also, 3 of the respondents in the Other category are the same for both questions. As the questions are presented here, the similarity of responses to the two questions should not be surprising. However, the explanatory material for the questions indicates that, as the Board intended, 2a) is a broader question that asks about additional elements in general, whereas 2b) is more specific; it asks whether, due to the unique nature of the federal government, additional elements are needed for certain transactions and other events, such as certain intangible resources, long-term social obligations, and other commitments.

Following are examples of the reasons given for *disagreeing* that additional elements are needed for certain transactions and other events (the ED position):

> If certain intangible resources, long-term social obligations, and other commitments meet both the elemental and recognition criteria, they should be handled according. No further additional elements need to be defined. [022—Non-Federal Other]

> We strongly disagree that FASAB should include additional elements for certain unique transactions and events. While there are a number of unique transactions and events in the Federal Government, these unusual transactions and events will meet the criteria for one of the defined elements. They may need to be specifically identified or disclosed in the financial statements, but those differences in presentation are covered by the Standards and should not be dealt with in this Concepts Statement. While these unique transactions and events may be reported separately, they still should be recognized in the financial statements in accordance with one of the defined elements contained in this Concepts Statement. [027—Federal Auditor]

> We do not believe that addressing items such as certain intangible resources, long-term social obligations, and other commitments require different or additional elements in accrual-basis financial statements . . . [040—Non-federal Other]

Many of the respondents who believe that additional elements *are* needed substantially repeat the elements they suggested in response to 2a). The following is an example of a more expansive response in favor of additional elements:

> Although most items can be categorized as an asset or a liability, the nature of some items do not fit the stringent definitions of either. The nature of social insurance obligations is different than a traditional liability. . . We believe that the FASAB should consider additional elements to provide a basis for further reporting requirements related to commitments and resources that do not meet the definitions of assets and liabilities. Furthermore, we are proposing additions to the definitions of assets and liabilities or their presentation in order to be more inclusive and more informative than when presented on the face of existing financial statements. [037—Federal Preparer]

Two respondents, although they appear to have opposing views, both support the concept of allowing for additional elements *in the future* rather than in the current proposed Concepts Statement:

> . . . [I]t may be desirable and indeed necessary that additional elements be considered. There is no denying that the Federal Government has unique powers and responsibilities. There could be additional elements that do not readily fit in the five proposed elements. The reference in the question to stewardship assets, stewardship investments, and social obligations bears this out. I do not think it would be harmful for the concepts statement to acknowledge the possibility that

> because of the unique nature of the Federal Government, certain additional elements might need to be defined. [001—Non-federal Other]
>
> We disagree that there are additional elements that need to be defined at this time. The FASB provides for accounting for intangible resources and long term liabilities which can be classified, measured and are probable. Anything outside of that would be an attempt to quantify the mission of the government on the face of the financial statements, which would hamper the comparability of statements from entity to entity as they may have different missions and different items represented in the financials. And while government financial reporting is different from commercial or not for profit financial reporting, it should not become so different as to create a whole new system of financial reporting and eliminate transparency from the financial reporting process so that only those with expertise in governmental financial reporting can understand the financial statements of reporting entities. Consideration for additional elements could occur later. [030—Federal Auditor]

Question 3

Do you agree with the position taken in (1) the proposed Concepts Statement [ED] or (2) the Alternative View [AV] concerning the potential effect of the government's ability to change laws on the recognition of a liability? Please explain the reasons for your position.
AGREE WITH:

ED POSITION 19 AV POSITION 7 OTHER 6

These responses sum to 32 because one of the responses excluded from the summary is included here because it contains comments that effectively respond to Question 3.

The ED POSITION group comprises 7 auditors (1 non-federal), 5 federal preparers, and 7 in the non-federal-other category. The AV POSITION group comprises 3 federal auditors, 3 federal preparers, and 1 in the non-federal-other category. The ED and the AV position groups can each be viewed as larger by four of the responses that are included in the OTHER group because they partially support one position and partially support the other. These four responses are Nos. 7, 9, 19, and 37. The first three defer to No. 37 (a consolidated response for a group of federal preparers) for responses to all questions. Response No. 37's response to 3a) indicates that some of the group members agree with the AV position and some agree with the ED position, as follows:

> Due to the fact that the federal government has the right to alter scheduled benefits in any manner at any time, some members support the alternative view that the government's power to change laws affects the existence of a present obligation. However, some members do believe that the presentation of obligations should be based upon information known at the time of preparation and not effected by possible changes in law. All members have not been given the opportunity to judge the possibility of alternative approaches to the presentation of these unusual elements and we hope this project can include those possibilities.
> Some members have stated an entity's balance sheet provides a snap shot of its financial position at a specific point in time. In order to provide open and full disclosure and accurately present the financial position of an entity at that given point in time, financial statements must be based on present laws, regulations, and generally accepted accounting principles regardless of whether or not that position may change in the future. Providing this full and open disclosure allows stakeholders to respond in a manner that could improve the future financial position of the entity

> (i.e. force change in current laws and regulations that may increase assets or reduce obligations of the Federal government).
> **Additional Comment** (in one "form" letter attached to No. 37): . . .The only exception [to the writer's support for the Alternative View in Appendix A of the ED] noted was found in A10 [par. A10 of the Alternative View] concerning present obligations. We noted that the ability of Congress to redefine future obligations is not measurable with any degree of accuracy. In the observance of the principle of conservatism, I express a dissenting opinion of the concept that changes in law "may provide additional evidence about whether a present obligation exists". We note that evidence "unless founded" in quantifiable measurable terms should not be considered present obligations.
> [037—Federal Preparer]

Response No. 8 in the Other category also can be read as supporting both positions. The respondent advocates disclosing both the ED position and the AV position in the notes to financial statements, for full disclosure. The remaining respondent in the Other category does not answer Question 3.

The responses that support the ED position in Question 3 generally provide similar reasons, regardless of the respondent's category. In addition to part of response No. 37 reproduced above, examples are:

> A basic postulate of accounting is that financial statements are prepared as if the reporting entity is a going concern. Accordingly, the statements are based on existing and likely to occur conditions. Although the government can modify the law related to non-exchange transactions, the same as it can abrogate or renegotiate contracts, it would seem financial statements need to report present obligations after giving due consideration to the likelihood and amount of payment. This is similar to what is presently done with contingent liabilities. [001—Non-federal Other]

> Paragraph 33 of the exposure draft states, "Implicit in the definition and essential characteristics of assets is that the event giving rise to the government's ability to control access to the economic benefits or services embodied in a resource must have occurred. The government's intent or ability to acquire a resource in the future does not create an asset. For the resource to qualify as an asset, the government already must have acquired the resource or otherwise obtained access to the resulting benefits or services to the exclusion of other entities, for example, the mere existence of the government's power to tax is not an asset because, until the government has exercised that power by imposing a tax and has access to benefits by virtue of completion of a taxable event, no event has occurred to generate resources and there are no resulting economic benefits that the government can control and use in providing programs and services**."**
> This should apply to government obligations as well. For the obligation to no longer qualify as a liability, the government must already have abandoned the obligation or otherwise revoked access to the promised benefits or services to the entitlees, for example, the mere existence of the government's power to cancel an obligation does not cancel a liability because, until the government has exercised that power by canceling a benefit and has denied access to benefits by virtue of completion of the canceling event, no event has occurred to reduce obligations and there are no resulting economic benefits that the government can control and use in providing programs and services.
> The FASAB should not attempt to anticipate the action or intent of future governing bodies by assuming a future governing body will change laws. A seated governing body should not be able to hide its accountability for establishing or increasing obligations because a future governing body may change the laws that established or increased the obligations. Conversely, the public

should be informed if a seated governing body reduces or eliminates existing obligations by changing current laws. Governing bodies have the ability to include provisions in current law that would increase, eliminate or reduce benefits or services in the future. Therefore if it was the intent of past and current representatives of the citizenry to increase, eliminate or reduce promised benefits or services in the future, then there would be such provisions in current law. [022—Non-federal Other]

We strongly agree with the position taken in the proposed Concepts Statement concerning the potential effect of the government's ability to change laws on the recognition of a liability. If and until the Government changes the law, the financial statements should reflect the current state of affairs. OMB Circular A-136 specifically requires Federal agencies to disclose the Government's ability to change laws on the recognition of a liability within the summary of significant policies of the financial statement footnotes. This footnote clearly discloses the Government's ability to change law and we believe no additional discussion is needed in the Concepts Statement. [027—Federal Auditor]

We agree with the proposed Concepts Statement and do not agree with the Alternative View. Our financial statements are representations of the financial condition of the government from a specific point in time. In order to be useful and reliable it is necessary to produce these statements based on current law, not on the possibility of a law changing in the future. Financial statements should provide the information needed to assess whether current law needs to be modified. In addition, adopting the alternative view approach could have adverse effects on many items other than social obligations. Many current liabilities are estimates based on current law, which will possibly change in the future, such as environmental liabilities. Proposing that such items may not be an obligation because a law may change in the future could result in an increase in off-balance sheet liabilities. Additionally, there are a number of things the government could do to eliminate their responsibility for liabilities, even if the probability of such action is, at best, remote (change laws, conquer nations, incarcerate individuals, simply refuse to acknowledge the debt). Shall we then remove all liabilities from the Balance Sheet based on these unforeseen events? Furthermore, this alternative concept could be applied to assets as well as liabilities, in that the government has the power to claim assets and resources that could result in misrepresentation if there is no basis of a past event or transaction that results in the ability to recognize the asset or resource. [028—Federal Preparer]

In addition to part of response No. 37 reproduced above, the following are examples of responses that support the AV position:

We agree with the position taken in the Alternative View. Paragraph 61 of the Concepts Statement, which is not part of the Alternative View, states that, "Measurement considerations also may result in postponing recognition of some assets or liabilities until their future outcomes become less uncertain or their measures become more reliable." Long-term social insurance benefits could be considered uncertain since there is on-going discussion regarding changes that are needed to the social security program and, as GAO has pointed out on numerous occasions, the program at its current benefit levels is unsustainable in the long-term. [006—Federal Auditor]

Because of our long interest in federal accounting standards and concepts, we are very concerned with one of the changes to US federal financial accounting concepts proposed in the ED. Specifically, we question the reasoning behind the proposed change of the definition of a liability. The nature of the federal government is truly unique, with characteristics and powers that no other entity—individual, corporation, or sub-national government—possesses. These characteristics and powers were one of the major reasons why a separate accounting standards board was created for the US Federal Government. These characteristics and powers permit the federal government to do things that no other entity can do. Specifically, the federal government—and the federal government alone—has the power to alter unilaterally its promises in the future. Stated another way using some of the language of the ED, the federal government has the power to change unilaterally a present obligation. No other entity can do this, yet the ED would use the same concept—a "liability"—to describe these transactions as are used to describe much different kinds of transactions made by other entities that do not have the powers of the federal government. My point here is not to say that these transactions don't belong somewhere in the federal government's financial statements. It is only to say that classifying these transactions the same as private sector liabilities is **wrong**: they are different and deserve a special classification—perhaps as "social obligations" or some other name, and perhaps as supplemental information to the financial statements, but not as "liabilities". [017—Non-federal Other]

Due to the fact that the Federal government has the right to alter scheduled benefits in any manner at any time, [Entity] supports the alternative view that the government's power to change laws affects the existence of a present obligation.
[Entity] does not support FASAB's position contained in the exposure draft because the definition of a liability would most likely require that future-scheduled social insurance obligations be reported as liabilities on both agency and governmentwide financial statements. [Entity] does not believe that future social insurance obligations are liabilities because they are neither contractual commitments nor present obligations of the Federal government. In addition, benefits for individuals are not directly tied to taxes they have paid, meaning that benefit entitlements are not exchange transactions. Further, [Entity] does not consider future-scheduled social insurance obligations as measurable from an audit perspective. [018—Federal Preparer]

I agree with the alternative view that the government's power to modify the law at any time and in any way affects the existence of a present obligation. The exposure draft states "the federal government is governed by and operates in a framework of laws". The primary document that provides that framework, the U.S. Constitution, gives Congress the power to change existing law. It is often said that one Congress cannot bind another. To state that present law should be considered but ignore the fact that the law can be changed at will is contradictory. [033—Federal Preparer]

Question 4

a) Do you agree that these two characteristics are essential characteristics of all federal government assets? If not, please give an example of a resource that you believe is an asset but does not possess one or both of these characteristics.
AGREE (ED POSITION) 27 DISAGREE 1 OTHER 3

The two characteristics are that the resources must embody economic benefits or services and that the government can control access to the economic benefits or services.

Respondents are almost unanimous in agreeing that the two characteristics are essential for all federal government assets. The single disagreement is from a federal auditor who believes that benefits can be non-economic, rather than being either economic or providing a service. The three respondents in the Other category do not answer the question.

b) Are there any *additional* characteristics that are *fundamental* or *essential* to *all* federal government assets?
NO (ED POSITION) 25 YES 2 OTHER 4

Again, respondents strongly support the ED position that there are no additional characteristics that are fundamental or essential to all federal government assets. The two respondents (1 federal auditor and 1 federal preparer) who propose additional characteristics suggest making the fact that the transaction or event giving rise to the asset has occurred an explicit characteristic, whereas it is stated in the ED to be implicit. The four respondents in the Other category (2 federal auditors, 1 federal preparer, and 1 non-federal-other) do not answer the question.

Question 5

a) Do you agree or disagree that these two characteristics are essential characteristics of all federal government liabilities? Please provide the reasons for your views. If you disagree, please give an example of an obligation or commitment that you believe is a liability but does not possess one or both of these characteristics.
AGREE (ED POSITION) 18 DISAGREE 5 OTHER 8

The two characteristics are that the government has a present obligation to provide assets or services to another entity and that the government and the other entity have an agreement or understanding as to when settlement is to occur.

There is strong support for the two proposed essential characteristics of liabilities, though slightly less than for the asset characteristics. The main disagreement appears to be with the settlement characteristic.

The AGREE (with ED position) group comprises 7 federal auditors, 6 federal preparers, and 5 in the non-federal-other category. The DISAGREE group comprises 3 auditors (2 are federal) and 2 non-federal-other. The Other group comprises 7 federal preparers and 1 federal auditor. The preparer responses in the Other group include No. 37—a consolidated group response of federal preparers—and Nos. 7, 9, 19, and 23 (all federal preparers). The first three defer to No. 37 for responses to all questions. However, response No. 19 also includes a preliminary draft of No. 37, which includes a response to 5a) (explicit agreement with the characteristics) that is absent from the submitted response No. 37. Staff has assumed that the preliminary draft was superseded. For 5a), response Nos. 23 and 37 are virtually identical. Portions of these responses contain areas of disagreement with the proposed definition of a liability (the topic of Question 6). If these comments are construed as disagreeing with the proposed characteristic, the number of responses in the DISAGREE group for 5a) would increase to 10. However, other portions of these responses present more than one view expressed by the contributors to the response, and still others discuss issues or conclusions unrelated to 5a). As a result, because of uncertainty about the totality of the responses, these 5 responses (7, 9, 19, 23, and 37) are included in the Other group. The three remaining respondents in the Other group do not respond to the question.

Almost all of the 18 respondents who agree that the two proposed characteristics are essential simply say "Yes" or "Agree" and some add a repeat of the characteristics from the ED. For example:

> We agree that these are the essential characteristics of federal government liabilities. There must be a present obligation to provide something of value and there must be an agreed or understood time of settlement. [006—Federal Auditor]

> Yes, [Entity] agrees that there are two characteristics that are essential characteristics of all Federal government liabilities. First, it constitutes a present obligation to provide assets or services to another entity. Second, the Federal government and the other entity have an agreement or understanding as to when settlement of the obligation is to occur. [018—Federal Preparer]

Of the 5 respondents who disagree, 3 auditors (2 federal) and 2 non-federal-other believe that an understanding or agreement concerning when settlement is to occur is not an essential characteristic of a liability. The other respondents advocate changes in the *definition* of a liability to include a notion of probability or contingency or to incorporate a reference to the occurrence of a past event. Examples of "disagree" responses are:

> We do not agree that an agreement or understanding between the federal government and the other entity "as to when settlement of an obligation is to occur" is an essential characteristic of a liability. It is possible for two parties to agree that an amount is owed by one party to the other, but disagree on, or be in the process of negotiations about, the timing of the settlement. Under such circumstances, there would clearly be a liability. We note that the IPSAS definition of liabilities does not require an agreement between the two parties. [031—Non-federal Other]

> We do not agree that the federal government and the other entity must have an agreement or understanding as to when settlement of the obligation is to occur. Whether or not the government is free to decide when to settle the obligation should not affect whether a liability exists. Uncertainty as to the timing of settlement would impact the measurement of the liability. The existence of a liability should be based solely on whether a present obligation exists which arose as a result of a past transaction or other event and has not yet been settled. [038—Non-federal auditor]

In the Other group, response Nos. 23 and 37 state that the proposed definition of liability is a "dramatic expansion" that will require recognizing items such as unfilled purchase orders as liabilities on the federal balance sheet. Staff talked with the authors of response No. 23 and reassured them that is not the Board's intent and pointed out that the text of the ED states that obligations (and assets) result from past transactions or events. The authors were appreciative of the clarification. However, from the discussion it was clear that their concern about the "expansion" of the liability definition to include unfilled orders had influenced their response to 5a) and other questions concerning the proposed liability definition.

Response No. 23 supports including "probable" in the definition of *present obligation.* Although that proposal refers to the definition, it suggests disagreement with the underlying characteristic of present obligation, as indicated by the following excerpt:

> [Entity] believes that the "present obligation" essential characteristic needs to state that the present obligation be "probable," consistent with SFFAS No. 5, paragraph 19 (see below) and FASB accrual-basis accounting for liabilities. [023—Federal Preparer]

Response No. 37 contains the same passage except that it states that only "some members" hold that belief. Similarly, response No. 23 rejects the "settlement" characteristic, whereas response No. 37 includes the same passage, but states that only "some members" hold that view:

> Some members believe that "settlement" is not an essential characteristic of a liability. If there is no agreement on when a liability will be paid, the liability still exists (i.e. the amount is still owed regardless of whether agreement or settlement has been reached or not). [037—Federal Preparer]

b) Are there any *additional* characteristics that are *fundamental* or *essential* to *all* federal government liabilities?
NO (ED POSITION) 24 YES 2 OTHER 5

Most of the NO respondents do not clarify their responses, but a few request clarification—for example,

> No, there are no additional characteristics that are fundamental or essential to all federal government liabilities but further clarification may be needed such as "probable future outlay of resources as a result of past actions or laws." [037—Federal Preparer]

The two respondents who suggest additional characteristics propose (1) a control characteristic that "should stipulate that the liability cannot be controlled, altered, or diminished at will by the federal government," for symmetry with the asset definition (federal preparer) and (2) explicit reference to the need for a past transaction or event to have occurred, and "claim to a resource" to incorporate assets such as fund balance with treasury (federal auditor). Most of the respondents in the Other group do not answer the question.

Question 6

a) Do the definitions of assets and liabilities adequately convey the essential characteristics from which they are derived? (See paragraphs 17 and 38.) If not, how would you modify the definitions?
YES (ED POSITION) 19 NO 10 OTHER 2

The YES group comprises 9 auditors (8 are federal), 6 federal preparers, and 4 non-federal-other. The NO group comprises 7 federal preparers, 2 non-federal-other, and 1 federal auditor. However, one of the preparers included in NO answers "No" for liabilities and "Yes" for assets. OTHER comprises 1 federal auditor and 1 federal preparer, who do not respond to the question.

Most of the YES respondents answer the specific question asked—whether the definitions adequately convey the essential characteristics from which they are derived—but do not elaborate. For example:

> Yes, we believe the definitions of assets and liabilities adequately convey the essential characteristics from which they are derived. [020—Federal Preparer]

> The definitions of assets and liabilities adequately convey the essential characteristics from which they are derived. [022—Non-federal Other]

In contrast, many of the respondents in the NO group do not state whether the definitions adequately convey the essential characteristics from which they are derived. Instead, they state their disagreement with the definition or propose modifications to it, or they state their assumptions about whether specific items would or would not meet the definition. Though these responses are technically "non-responsive," staff has included them to give the Board an idea of some of the reservations or disagreements that some respondents have. For example, the following excerpts from responses assigned to the NO group advocate *different definitions*, rather than stating whether the definitions proposed in the ED adequately reflect the essential characteristics proposed in the ED.

> We believe that the definition of asset and liability should be expanded to include the concept of probability, because assets are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events and liabilities are probable future sacrifice of economic benefits arising from present obligations. [032—Federal Preparer]

> Yes, the definitions of assets and liabilities should be derived from their fundamental or essential characteristics. However, we believe the definitions for these elements should be similar to the definitions contained in the Financial Accounting Standards Board's (FASB) Concept 6, *Elements of Financial Statements*. Currently, the definitions in SSFAS No. 6 (Appendix E Glossary) and SFFAS No. 5 (Paragraph 19) are very similar to those in FASB Concept 6. [035—Federal Auditor]

b) Do the definitions of net position, revenues, and expenses adequately convey their relationship to assets and liabilities? (See paragraphs 50, 52, and 53.) If not, how would you modify the definitions?
YES (ED POSITION) 20 NO 8 OTHER 3

The YES group comprises 9 federal preparers, 8 auditors (7 are federal), and 3 non-federal-other. The NO group comprises 4 federal preparers, 3 non-federal-other, and 1 federal auditor. OTHER comprises 2 federal preparers and 1 non-federal-other, who do not respond to the question.

Seventeen of the 19 respondents who answer YES to 6a) on the definitions of assets and liabilities also say YES to 6b) on the definitions of net position, revenues, and expenses. One of the remaining respondents (non-federal-other) says NO to 6b) and the other (federal preparer) does not answer 6b). In contrast, three of the 10 respondents who answer NO to 6a) say YES to 6b); all three are federal preparers. The remaining 7 respondents answer NO to both 6a) and 6b).

As indicated for 6a) the "Yes" responses to 6b) generally respond to the specific question but do not elaborate. Also, they say "Yes" for all three elements: net position, revenues, and expenses.

In contrast and also as indicated for 6a), respondents in the NO group generally do not answer the specific question, but rather propose different definitions. Also, many of them agree with the revenue definition, but disagree with the definitions of net position and/or expenses. Some examples of these responses are:

> . . . We propose revising the definition [of revenue] as follows: "A revenue is an increase in assets, a decrease in liabilities, or a combination of both from providing goods or services, levying taxes or other impositions, receiving donations, or any other activity relating to the entity's ongoing programs and missions." This definition incorporates the concept that activities which are fundamental to an entity's ongoing major or central operations are considered revenue. We believe that incorporating this language into the FASAB definition would benefit federal government users, because the current wording of "any other activity….performed during the reporting period" is too broad and vague. [016—Federal Auditor]

> Net Position Definition: No. The definition for net position described in SFFAC No.2 paragraph No.84 includes a more precise definition which elaborates on the primary components of Unexpended Appropriations and Current Results of Operations . . .
> Revenue Definition: Members generally agree with the Exposure Draft definition of Revenue.
> Expense Definition: Some members believe that the definition of expense is very unclear, and respectfully recommends the following rewording: "An expense is a decrease in assets, an increase in liabilities, the consuming or adjusting of assets, or a combination of the above from the receipt of goods or services or any other activities during the reporting period." [037—Federal Preparer]

> As noted in the response to Question 1 (b), we believe that the definitions of revenues and expenses should be defined based on each element's own inherent characteristics. The definition of net position does adequately convey its relationship to assets and liabilities. [040—Non-federal Other (standard setter)]

Question 7

Are there *other* criteria that should be established as conditions for recognition? If so, what recognition criteria would you add or delete?

NO (ED POSITION) 19 YES 7 OTHER 5

The NO group comprises 9 federal preparers, 8 auditors (7 are federal), and 2 non-federal-other. The YES group comprises 5 federal preparers, 1 federal auditor, and 1 non-federal-other. The OTHER group comprises 3 non-federal-other, 1 federal preparer, and 1 federal auditor, who do not answer the question.

Most of those who agree with the ED position generally do not elaborate on their response. The following are examples of brief responses followed by two more expansive responses:

> There are no other criteria that should be established as conditions for recognition. [013—Federal Auditor]

> [Entity] is not aware, at this time, of any other criteria that should be established as conditions for recognition. [023—Federal Preparer]

No. The proposed conditions are sufficient and appropriate criteria. [038—Non-federal Auditor]

There are no criteria that should be established as conditions for recognition other than (1) the item must meet the definition of an element and (2) the item must be measurable.
[Entity] concurs with the recognition criteria outlined in paragraph 5 (a) and (b) of this exposure draft. [Entity] believes that it should be clearly stated within Paragraphs 5 thru 9 that "diligent effort should be taken to recognize all material elements or items, despite measurement difficulties." The vast majority of material elements or items are measurable in a way that is superior to not measuring them at all. [022—Non-federal Other]

We agree with the following statement from paragraph #4 of the exposure draft on recognizing an element into the financial statements: "that recording not only the acquisition or incurrence of the item but also later changes in it, including changes that result in removal from the financial statements." Also, paragraph #5 of the exposure draft addresses measurability of the item: "Measurement of an item includes an assessment of the probability of future inflows or outflows of resources or services resulting from that item in a manner that is consistent with the measurement attribute being used". The above statements (along with the other statements in the exposure draft) are sufficient explanations of the recognition criteria. We disagree with the alternative view, with the explicit thresholds standards that would be applied measurability of the elements. [030—Federal Auditor]

The respondents who say YES, there should be additional criteria for recognition, give various explanations or suggestions—for example:

We agree with the members supporting the alternative view that recognition criteria in the final statement should be comprehensive and should include all factors relevant to determining whether an item should be recognized. Providing complete criteria will prove most useful to the Board as it deliberates standards and to users as they seek to apply them. [021—Federal Auditor]

Incorporating as a recognition criterion the probability that the economic benefits associated with an item would flow from or to the reporting entity may be a compromise between the position put forward by the exposure draft and the alternative view. The exposure draft's position is that probability is implicit in the measurement of an item but does not require to be explicitly mentioned; the alternative view is that the concept of probability should be explicitly incorporated both in deciding whether an item meets the definition of an element and whether any such element is measurable.
Paragraph 8 of the exposure draft could give the impression that the FASAB is proposing "materiality" as a third recognition criterion. Materiality is generally viewed as one of the qualitative characteristics of financial statements, and as indicated in the response to Question 10 below, we do not believe that it is necessary or useful to repeat all the qualitative characteristics as part of the recognition criteria. The relevant text could be made clearer. [031—Non-federal Other]

We recommend adding the criteria of relevance and reliability. Relevance and reliability are two primary qualitative characteristics of accounting information. Both these elements are critical for decision usefulness. No matter how reliable, if information is not relevant to the decision at hand, it is useless. Conversely, relevant information is of little value if it cannot be relied on. [032—Federal Preparer]

Question 8

Do you agree with the position taken in (1) the proposed Concepts Statement [ED] or (2) the Alternative View [AV] concerning the need for an explicit requirement for an assessment of probability and a related probability threshold when determining whether an item meets the definition of an element? Please explain the reasons for your position.

AGREE WITH:

ED POSITION 13 AV POSITION 13 OTHER 5

Respondents who agree with the ED position comprise 5 auditors (4 are federal), 4 federal preparers, and 4 non-federal-other. The group that agrees with the AV position comprises 8 federal preparers and 5 federal auditors. OTHER comprises 2 non-federal-other, 2 federal preparers and 1 federal auditor. One of the preparers agrees with the AV position concerning an assessment of probability but agrees with the ED position that the ED should *not* include a probability threshold. The remaining respondents in the OTHER group do not respond to the question.

As shown, respondents are evenly divided between the ED and AV positions with respect to the need for an explicit requirement for an assessment of probability and a probability threshold at the *definition* stage. Responses in both groups are quite extensive and many of them explain the reasons for their views.

There is considerable consistency between the responses to Questions 8 and 9. Many of the responses to Question 8, which refers to *definition*, are repeated verbatim or almost verbatim in response to Question 9, which refers to *measurability*. Twelve of the 13 respondents who agree with the ED position in Question 8 also agree with the ED position in Question 9, and 11 of the 13 respondents who agree with the AV position in Question 8 also agree with the AV position in Question 9. Almost all respondents to both questions give the same response for assessments of probability and probability thresholds. However, as previously noted, one federal preparer agrees with the need for assessments but disagrees that there is a need for thresholds.

Examples of responses that agree with the ED position follow.

> We agree with the position taken in the proposed Statement and do not believe its adoption will result in many more items being recognized. While we agree that there may be an implicit assessment of probability, we do not agree that thresholds should be applied. We believe explicit definitions or formulas for assessing and measuring probability run the risk of excluding many more items from recognition.
> Furthermore, we suggest a review of FASB Concept No. 6 paragraph 25, and especially footnote 18 which states "Probable is used with its usual general meaning, rather than in a specific accounting or technical sense." We do not believe that the FASAB Concept Statement should imply otherwise. [029—Federal Preparer]

Respondent No. 29 gives the same response to Question 9.

We agree with the proposed Concepts Statement that the existence of an element is judgmental, based upon available evidence. Implicit in this statement is some type of measurement as to whether or not it meets the definition of an element. Explicit standards, thresholds and existence probability proposed in the Alternative View would force federal agencies into a "one size fits all" approach to the financial statements. Additionally, it would needlessly complicate the Concepts Statement. It is sufficient to let the individual federal agencies decide, after their own judgment, whether an item possesses the characteristics of an element, and assess the probability of future inflows or outflows from the item. [030—Federal Auditor]

It seems to us that the proposed ED adequately addresses the need for judgment in determining the existence of an asset or liability and the amount of such asset or liability. As stated in the AV, the need for an assessment and a threshold is implicit in the ED. We are concerned that if the ED explicitly requires an assessment and a threshold, preparers would be “forced” by auditors to specifically examine and document the existence and value of each asset and liability separately from the ordinary course of business. When there is a significant question about existence or value of an asset, such documentation is appropriate. However, new and separate documentation should not be required. Therefore, while we do not have a major problem with explicitly stating the need for such an assessment, we prefer the ED to imply the need (as written) with any explicit requirements included in separate standards as required.
It would be helpful if the proponents of the AV provided examples of the types of items that may be recognized that have a low probability of being assets or liabilities.
The example in footnote 12 [Alternative View, par. A8] seems to be a contingent liability for which there are adequate standards and therefore does not require additional discussion in this ED. [039—Non-federal Other]

We do not believe that there is a need for an explicit requirement for an assessment of probability and a related probability threshold when determining whether an item meets the definition of an element. [040—Non-federal Other (standard setter)]

Following are examples of responses that agree with the AV position.

[Entity] agrees with the alternative view. We believe that an explicit requirement for an assessment probability threshold should be included in the discussion. This would help agencies determine whether an item meets the definition of an element. The lack of a probability threshold could open the door for many items to be unnecessarily accounted and the result would make the financial statements less meaningful. [020—Federal Preparer]

We agree with the alternative view expressed in paragraphs A1 through A4 of the proposed Statement that the proposed Concepts Statement should clearly state that probability should be “assessed as part of determining whether an item meets the definition of an element (existence probability)….” Our view is that one probability standard applicable in all cases could be used. As we stated in our response to Question **#4**, we propose that the word “probable” be included in the definitions of assets and liabilities. If the assessment of future probability is not included in the definitions, readers will have no parameters that can be used to judge whether an amount is an asset or liability or another element. Also, we believe that one result of adding the probability assessment to the Statement will be increased reliability and consistency in government financial statements. [016—Federal Auditor]

Respondent No. 16 disagrees with the AV position in Question 9.

Incorporating as a recognition criterion the probability that the economic benefits associated with an item would flow from or to the reporting entity may be a compromise between the position put forward by the exposure draft and the alternative view. The exposure draft's position is that probability is implicit in the measurement of an item but does not require to be explicitly mentioned; the alternative view is that the concept of probability should be explicitly incorporated both in deciding whether an item meets the definition of an element and whether any such element is measurable.
Paragraph 8 of the exposure draft could give the impression that the FASAB is proposing "materiality" as a third recognition criterion. Materiality is generally viewed as one of the qualitative characteristics of financial statements, and as indicated in the response to 10 a) below, we do not believe that it is necessary or useful to repeat all the qualitative characteristics as part of the recognition criteria. The relevant text could be made clearer.] [031—Non-federal Other]

Respondent No. 31 gives the same response to Questions 7 and 9.

Question 9

Do you agree with the position taken in (1) the proposed Concepts Statement [ED] or (2) the Alternative View [AV] concerning the need for an explicit requirement for an assessment of probability and a probability threshold when determining whether an item is measurable? Please explain the reasons for your position.
AGREE WITH:
ED POSITION 14 AV POSITION 12 OTHER 5

The responses to Question 9 are slightly more in favor of the ED position than was the case for Question 8. The group that agrees with the ED position comprises 6 auditors (5 are federal), 4 non-federal-other, and 4 federal preparers. Respondents who agree with the AV position comprise 7 federal preparers, 3 federal auditors, and 1 non-federal-other. OTHER comprises 2 non-federal-other, 2 federal preparers, and 1 federal auditor.

Staff comments concerning Question 8 note the consistency between the responses to Questions 8 and 9 and the fact that some of the respondents provide identically worded responses to both questions. Some of those responses are included under Question 8 above and are not repeated here.

Some of the other responses that agree with the ED position in Question 9 follow. They give various reasons for their position.

I agree with the proposed Concepts Statement. The rationale for measuring items can be justified in many ways. An assessment may not ultimately provide any different conclusions but instead be used to support an initial judgment. [014—Federal Auditor]

We do not agree with the Alternative View that the Statement should be revised to explicitly state language about the application of thresholds to determine probability of measurement. We believe that readers understand the application of measurability. However, we suggest adding the following sentence to the Statement for further clarification: "An item is measurable if it can be determined with reasonable certainty or is reasonably estimable." [016—Federal Auditor]

> Again [as stated in response to Question 8], [Entity] believes that probability is always an issue that must be trusted to conservative professional judgment as stated above. Once again, the specific mentioning of probability in this Concept Statement seems directed toward keeping elements off of the basic financial statements. Further, if the probability of being unable to measure a recognizable element is grossly material, conservative professional judgment will require the financial report's auditors to consider an adverse opinion or disclaimer of opinion. [022—Non-federal Other]

> [Entity] disagrees with the Alternative View that the proposed Concept Statement should state that "there exists a threshold where such probability is so low that an item would not meet the definition of an element. Thresholds to be applied would, as appropriate, be established in specific standards." [Entity] believes that federal entities should have the latitude to exercise their judgment in determining if it is probable or not probable that an item is measurable. [023—Federal Preparer]

Following are some responses that agree with the AV position, including the reasons given:

> We agree with the position taken in the Alternative View concerning the need for an explicit requirement for an assessment of probability and a probability threshold when determining whether an item is measurable. As part of the decision-making process (i.e., judgment), an individual would use the concept of "probability" to weigh various factors, based on available evidence, in order to conclude on whether an item is measurable. [013—Federal Auditor]

> [Entity] concurs with the Alternative View concerning the need for an explicit requirement for an assessment of probability threshold when determining whether an item is measurable. If the item does not meet the probability threshold, it is irrelevant whether it is measurable. [018—Federal Preparer]

> We concur with the Alternative View concerning the need for an explicit requirement for an assessment of probability threshold when determining whether an item is measurable. If the item does not meet the probability threshold then it is unreliable; and therefore, is also irrelevant regardless of whether or not it is measurable. [037—Federal Preparer]

Question 10

Do you agree with the position taken in (1) the proposed Concepts Statement [ED] or (2) the Alternative View [AV] concerning the need for a consideration of the qualitative characteristics of financial statements as part of determining whether an item meets the recognition criteria? Please explain the reasons for your position.
AGREE WITH:

ED POSITION 12 AV POSITION 16 OTHER 3

Respondents who agree with the ED position comprise 6 auditors (5 are federal), 5 non-federal-other, and 1 federal preparer. Those who agree with the AV position comprise 11 federal preparers and 5 federal auditors. OTHER comprises 2 non-federal-other and 1 federal preparer, who do not answer the question.

Many respondents appear to have captured the difference between the ED position and the AV position on whether the qualitative characteristics should be specifically included in the Concepts Statement on Elements. The ED position is that the qualitative characteristics are included in SFFAC 1, are not ignored or superseded by the proposed Concepts Statement on Elements (they are referred to in paragraph 1 of the ED), and should not be repeated in the Concepts Statement on Elements. The AV position is not the opposite of that position; it calls for "a consideration of the qualitative characteristics of financial statements as part of determining whether an item meets the recognition criteria." As presented in Question 10, that position may have been interpreted by some respondents to mean that the ED concepts do not contemplate consideration of the qualitative characteristics and, therefore, they need to be specifically included in the ED text.

Several excerpts from the responses illustrate the differing conclusions and reasoning of the respondents. Examples of respondents who agree with the ED position are:

> We agree with the position taken in the proposed Concepts Statement. We interpret SFFAC 1 to mean that overall the information in financial reports should have those qualitative characteristics. Some information by its nature may be difficult for readers to understand or may not seem relevant to them, but may in fact be required for complete financial reporting. Although the qualitative characteristics should be taken into account when making decisions as to what to include in financial statements, we do not believe those characteristics need to be repeated in this Concepts Statement. Nonetheless, it may be helpful to include some type of reference to SFFAC 1. [006—Federal Auditor]

> If already published and not changed by this Concepts Statement, including the qualitative characteristics is unnecessary and confusing. The Concept Statement, to be effective, should limit itself to the specific subject of the concept. Including it in the Concept Statement would serve the same purpose as the specific inclusion of probability**.** [022—Non-federal Other]

> We disagree with the Alternative View that qualitative characteristics should be considered in determining whether management should recognize an item in the financial statements. The characteristics in SFFAC 1 relate to the statements taken as a whole. We don't believe these necessarily relate to whether or not individual components are recognized in the financial statements. [027—Federal Auditor]

> We agree with the proposed Concepts Statement (1). As noted above, we have no problems with general statements that qualitative characteristics be considered, but see no real "need" to place that statement in this standard. In addition, we would like to see examples of the types of items that might be included as assets or liabilities if the qualitative factors are not considered. [039—Non-federal Other]

Examples of respondents who agree with the AV position are:

> We agree with the position taken in the Alternative View concerning the need for a consideration of the qualitative characteristics of financial statements as part of determining whether an item meets the recognition criteria. Because SFFAC 1 states that the information in financial reports must have the basic characteristics of understandability, reliability, relevance, consistency, and comparability in order to effectively communicate to those who use financial information, it is reasonable that those same basic characteristics should be used in considering whether items meet

the recognition criteria and should therefore be reported in the financial statements. As a result, the ED should explicitly acknowledge that the qualitative characteristics need to be considered in making decisions on whether an item meets the recognition criteria. [013—Federal Auditor]

We agree with the Alternative View that language should be added to the Statement that consideration of the qualitative characteristics should be a part of recognition decisions. Readers should be informed that the decision to recognize an item must include an assessment of such characteristics as relevance and reliability. We also believe that the proposed Statement should include a description of the qualitative characteristics. As stated in Paragraph A9, if the other conceptual framework projects do not address the characteristics, they should be addressed in this Statement. [016—Federal Auditor]

The alternative view (2) is the view of choice. The qualitative characteristics should be grouped with the elements so that a comprehensive and cohesive picture is presented of the relevant factors required to make a sound accounting decision. SFFAC #1 details a general discussion on the federal reporting environment and not the specifics of providing a framework to support standardized accounting practices and decision making. The elements, qualitative characteristics and the accounting constraints (materiality, conservatism, specialized practices, and cost vs. benefit) serve as building blocks or a step by step process to support accounting practices utilized and should be consolidated and reported within one conceptual statement. [020—Federal Preparer]

[Entity] agrees with the Alternative View regarding the consideration of the six qualitative characteristics of financial reports when determining if an item should be recognized in a financial report (i.e. meets the recognition criteria.) The six qualitative characteristics of financial reports are important to federal entities' financial reporting, and if the recognition of an item in a financial report is not consistent with one or more of these characteristics, then that should be considered when determining if an item should or should not be reported in a financial report. [023—Federal Preparer]

Qualitative characteristics, as covered in SFFAC 1, are a consideration underlining the financial statements. Paragraph 1 of the proposed concepts states this concept is consistent with earlier Concepts. Re-stating the qualitative characteristics in the proposed concept would greatly reduce confusion of whether these characteristics are to be considered in this concept. In addition, this would enhance reader ease. [028—Federal Preparer]

OTHER COMMENTS BY RESPONDENTS

Staff has focused in this summary on the responses to the Questions for Respondents which the Board selected for inclusion in the ED. Many respondents provide comments and recommendations that do not respond to those questions but nevertheless may be helpful to the Board. Some of that material is not within the scope of the Elements ED, such as requests for clarification of certain FASAB standards and comments on social insurance issues. Other material is related to the ED but, in staff's view, would be better addressed in staff papers and discussions of the issues that the Board decides to redeliberate, because there would be a greater opportunity to discuss the material than is possible in a summary of this nature. A few topics are mentioned here as examples of the breadth of responses to the ED.

Recommendations for Clarifications or Changes in the ED Text: Numerous respondents recommend clarifications or changes, including some in the use or definition of terms, some in the precise wording for the definitions of elements or related descriptions, and some that are purely editorial.

Other Definitions of Elements: Five respondents (mostly federal preparers and at least one being a collective response) express a preference for existing definitions of elements, such as those in SFFAC No. 2, SSFAS No. 5, SSFAS No. 6, and/or FASB Concepts Statement No. 6. A few respondents mention evolving definitions as preferred or potentially preferred, such as those under development by the GASB and those existing in IPSASB standards or to be developed in the IPSASB's future project to develop a conceptual framework. Some respondents recommended joint development of elements definitions between FASAB and another standard setter.

Effects of Proposed Definitions: Several respondents question or speculate on the effect of the proposed definitions on the treatment of certain transactions, such as those related to social insurance programs.

CONCLUSIONS

Support for the ED is strong in the responses to six of the Questions for Respondents: Questions 1, 3, 4, 5, 6, and 7, including their subparts, and is particularly strong for Questions 1a), b), and c); 4a) and 4b); and 5b). The issues they cover and the ED position are as follows:

Question 1a) on deriving definitions of assets and liabilities from their essential characteristics: YES
Question 1b) on deriving the definitions of net position, revenues, and expenses from the definitions of assets and liabilities: YES
Question 1c) on the separation of definition and recognition—e.g., an item that meets the definition of an asset is an asset even if it does not meet recognition criteria: YES
Question 3 on whether the Congress's ability to change the law should affect the existence or recognition of a liability: NO
Question 4a) on whether the two essential characteristics proposed in the ED are essential characteristics of all federal government assets: YES
Question 4b) on whether there are any other characteristics that are essential characteristics of all federal government assets: NO
Question 5a) on whether the two essential characteristics proposed in the ED are essential characteristics of all federal government liabilities: YES
Question 5b) on whether there are any other characteristics that are essential characteristics of all federal government liabilities: NO
Question 6a) on whether the proposed definitions of assets and liabilities adequately convey the essential characteristics from which they are derived: YES
Question 6b) on whether the proposed definitions of net position, revenues, and expenses adequately convey the essential characteristics from which they are derived: YES
Question 7 on whether there are criteria other than those proposed in the ED that should be established as conditions for recognition: NO

Both the responses that support the ED position and those that do not support that position include comments and proposals that the Board may wish to consider. Respondents' reasoning and proposals can be explored more thoroughly in the Board's discussion of the issues that it decides to redeliberate.

In contrast to the above six questions, the responses are quite evenly divided on the following questions and issues:

Question 2a) on whether there are additional elements of accrual-basis financial statements that should be defined in the Concepts Statement (general question).
Question 2b) on whether there are additional elements of accrual-basis financial statements that should be defined in the Concepts Statement (more specific question in relation to the unique nature of the federal government).
Question 8 on whether the Concepts Statement should include an explicit requirement for an assessment of probability and a related probability threshold when determining whether an item meets the definition of an element.
Question 9 on whether the Concepts Statement should include an explicit requirement for an assessment of probability and a related probability threshold when determining whether an item is measurable.
Question 10 on whether the Concepts Statement should include the qualitative characteristics established in SFFAC 1 and whether the Concepts Statement should require a consideration of all of the qualitative characteristics in determining whether an item meets the recognition criteria.

The tabulations of the responses indicate a general difference in responses depending on the respondent's category in the responses to some of the questions. For example, those that support the ED position in response to Questions 2a) and 2b) are mostly auditors and those who do not support the ED position in 2a) and 2b) are mostly preparers and non-federal-other. For Questions 6a), 6b) and 7, respondents who disagree with the ED position (a minority in each case) are mostly preparers. For Questions 8, 9, and 10—ED versus AV questions—the categories of respondents are quite evenly divided in favor of one position or the other.

In the responses to many of the questions, regardless of the respondent's position, staff has found instances where the respondent has misinterpreted or misstated certain proposals or definitions. Also, many respondents propose clarifications or changes in the wording in various parts of the ED, including elimination of some discussions. Some of these findings may not extend to readers in general, whereas others may support reexamination of the clarity of various definitions and discussions in the ED, as well as whether certain sections of the ED can or should be changed or eliminated.

Staff plans to present a paper on some of the ED issues at the November meeting.

ATTACHMENT 1

DEFINITION AND RECOGNITION OF ELEMENTS OF ACCRUAL-BASIS FINANCIAL STATEMENTS

Questions for Respondents

The FASAB encourages you to become familiar with all proposals in this proposed Concepts Statement before responding to the questions in this section. The paragraphs cited in parentheses in a question are particularly relevant to that issue, but other portions of the document also may enhance your understanding of the question.

The Board also would welcome your comments on other aspects of the proposals in this proposed Concepts Statement. Because the proposals may be modified before a final Concepts Statement is issued, it is important that you comment on proposals that you agree with as well as any that you disagree with. Comments that include the reasons for your views will be especially appreciated.

The questions in this section are available in a Word file for your use at www.fasab.gov/exposure.html. Comments should be sent by e-mail to comesw@fasab.gov. If you are unable to respond by e-mail, please fax your responses to (202) 512-7366 and follow up by mailing your responses to:

Wendy M. Comes, Executive Director
Federal Accounting Standards Advisory Board
Mailstop 6K17V
441 G Street, NW, Suite 6814
Washington, DC 20548

All responses are requested by August 5, 2006.

1. Two principles underlie the FASAB's approach to defining and recognizing elements of accrual-basis financial statements of the federal government.

   The first principle is that the definitions of assets and liabilities should derive from identifying the *fundamental* or *essential characteristics* that all assets and liabilities, respectively, share. The definitions of net position, revenues, and expenses should derive from the definitions of assets and liabilities. (See paragraphs 3, 19, 21, 40, and 49.)

   a) Should the definitions of assets and liabilities derive from their fundamental or essential characteristics? Please provide the reasons for your position and any alternative approach(s) you would take to define assets and liabilities.
   b) Should the definitions of net position, revenues, and expenses derive from the definitions of assets and liabilities? Please provide the reasons for your position and any alternative approach(s) you would take to define net position, revenues, and expenses?

   The second principle is that definition and recognition are separate concepts. An item that meets the definition of an asset is an asset but to be recognized the asset also must meet the recognition criteria. Thus, meeting the definition of an element is a necessary but not a sufficient condition for an item to be recognized in financial statements. An asset that is not recognized in the body of a financial statement would be a candidate for disclosure in the notes. (See paragraphs 4–6, 8, and 9.)

c) If an item meets the definition of an asset is it an asset even if it is not recognized in the body of a financial statement because, for example, it is not measurable or its amount is not material? Please provide the reasons for your position.

2. The proposed Concepts Statement defines five elements of accrual-basis financial statements: *assets, liabilities, net position, revenues* and *expenses*. (See paragraphs 2, 3, 35-37, and 56.)

a) Are there additional elements of accrual-basis financial statements that should be defined in the Concepts Statement? If so, what are they and what are their essential characteristics? Alternatively, what are they and how would you define them?

Some constituents believe that because of the unique nature of the federal government additional elements are needed for certain transactions and other events. For example, certain intangible resources, long-term social obligations, and other commitments are viewed by these constituents as requiring a different element or elements than those identified in this proposed Concepts Statement.

b) Do you agree or disagree that there are additional elements that need to be defined? If you agree, what are the essential characteristics of these elements? Please provide examples of the types of transactions that align with these additional elements.

3. The proposed Concepts Statement addresses the government's ability to change laws in the future as stated in paragraph 44 as follows:

To meet the definition of a liability, the federal government's contract or other agreement to provide assets or services to another entity must be based on *existing* conditions, including current law, because an essential characteristic of a liability is that the government has a *present* obligation, even if conditions may change before settlement is due. For example, the Congress may change a law under which the federal government has incurred a present obligation and erase the obligation or otherwise enable the government to avoid settlement. Alternatively, the government may be able in the future to renegotiate the obligation with the payee or recipient of the promised services. However, liabilities and all other elements of accrual-basis financial statements are based on transactions or events that already have occurred. The government's power to change existing conditions does not preclude what otherwise would be a present obligation and recognized as a liability.

Members with an alternative view believe that the government's power to modify the law to change or withdraw future benefits related to nonexchange transactions could affect the existence of a present obligation. Consequently, these Board members believe that the government's ability to change the law may provide additional evidence about whether a present obligation exists and, in some instances, may preclude recognition of a liability. Therefore, they disagree with paragraph 44. (See appendix A, page 20.)

a) Do you agree with the position taken in (1) the proposed Concepts Statement or (2) the Alternative View concerning the potential effect of the government's ability to change laws on the recognition of a liability? Please explain the reasons for your position.

4. The proposed Concepts Statement identifies two, and only two, characteristics that are *fundamental* or *essential* to *all* federal government assets: (a) An asset embodies economic benefits or services that can be used in the future and (b) the government can control access to the economic benefits or services and therefore, can obtain them and deny or regulate the access of other entities. (See paragraphs 19 and 21–34.)

    a) Do you agree that these two characteristics are essential characteristics of all federal government assets? If not, please give an example of a resource that you believe is an asset but does not possess one or both of these characteristics.
    b) Are there any *additional* characteristics that are *fundamental* or *essential* to *all* federal government assets?

5. The proposed Concepts Statement identifies two, and only two, characteristics that are *fundamental* or *essential* to *all* federal government liabilities: (a) A liability is a present obligation to provide assets or services to another entity and (b) the federal government and the other entity have an agreement or understanding as to when settlement of the obligation is to occur. (See paragraphs 37 and 40–48.)

    a) Do you agree or disagree that these two characteristics are essential characteristics of all federal government liabilities? Please provide the reasons for your views. If you disagree, please give an example of an obligation or commitment that you believe is a liability but does not possess one or both of these characteristics.
    b) Are there any *additional* characteristics that are *fundamental* or *essential* to *all* federal government liabilities?

6. As indicated in Question 1a), the first principle of the Board's approach to defining elements is that the definitions of assets and liabilities should derive from their essential characteristics, and the definitions of net position, revenues, and expenses should derive from the definitions of assets and liabilities.

    a) Do the definitions of assets and liabilities adequately convey the essential characteristics from which they are derived? (See paragraphs 17 and 38.) If not, how would you modify the definitions?
    b) Do the definitions of net position, revenues, and expenses adequately convey their relationship to assets and liabilities? (See paragraphs 50, 52, and 53.) If not, how would you modify the definitions?

7. The proposed concepts statement establishes two conditions ("recognition criteria") that should be met for an item to be recognized in the body of a financial statement: (1) The item must meet the definition of an element and (2) the item must be measurable. (See paragraphs 4 and 5.)

    a) Are there *other* criteria that should be established as conditions for recognition? If so, what recognition criteria would you add or delete?

8. The proposed Concepts Statement neither explicitly requires nor precludes an assessment of probability when deciding whether an item meets the definition of an element, nor does the Statement establish an explicit threshold of probability at the definition stage. Rather, the Statement indicates that conclusions about the *existence* of an element require judgment as to

whether, based on the available evidence, an item possesses the essential characteristics of an element. The Statement indicates that when an element is considered for *recognition*, measurement of the element may require an assessment of the probability of future inflows or outflows of resources to or from the element to enhance the reliability of amounts recognized in the financial statements. In addition, the Statement explicitly acknowledges that assessments of the materiality and benefit versus cost of recognizing the results of the measurement of elements may constrain recognition. Members believe that this framework permits future standard setters to adequately address uncertainty with respect to recognition decisions in establishing future standards. (See paragraphs 7, 8, 18, and 39.)

Members with an Alternative View believe that, in deciding whether an item meets the definition of an element and considering related uncertainties, there is implicitly an assessment of the probability of whether an item meets the definition of an element and that, because there is a decision to be made, that there is implicitly a probability threshold where an item would not meet the definition of an element. These members believe that the proposed Concepts Statement should explicitly state that (1) the probability that an item meets the definition of an element should be assessed as part of determining whether an item meets the definition of an element ("existence probability"), and (2) there exists a threshold where such probability is so low that an item would not meet the definition of an element. Thresholds to be applied would, as appropriate, be established in specific standards. In the view of these members, the lack of an explicit acknowledgement of the need for an existence probability assessment and a probability threshold at the definition stage would be likely to result in many more items being recognized in the financial statements, including items with a low probability of being assets or liabilities. (See Appendix A: Alternative Views, page 25.)

a) Do you agree with the position taken in (1) the proposed Concepts Statement or (2) the Alternative View concerning the need for an explicit requirement for an assessment of probability and a related probability threshold when determining whether an item meets the definition of an element? Please explain the reasons for your position.

9. The proposed Concepts Statement defines "measurable" as "means quantifiable in monetary units." (par. 5) The proposed Concepts Statement does not explicitly discuss an assessment of probability when deciding whether, based on the available evidence, an item is measurable or that there is a point or threshold at which an item is not measurable. The Statement does discuss the consideration of uncertainty, cost-benefit and materiality and how these factors influence standard setting. (See paragraphs 57-61)

   Members with an Alternative View believe that, in deciding whether an item is measurable and considering related uncertainties, there is implicitly an assessment of the probability of whether an item is measurable and that, because there is a decision to be made, that there is implicitly a probability threshold where an item would not be measurable. These members believe that the proposed Concepts Statement should explicitly state that (1) the probability that an item is measurable should be assessed as part of determining whether an item is measurable ("measurability probability"), and (2) there exists a threshold where such probability is so low that an item would not be measurable. Thresholds to be applied would, as appropriate, be established in specific standards. In the view of these members, the lack of an explicit acknowledgement of the need for a measurability probability assessment and a probability threshold would be likely to result in many more items being recognized in the financial statements, including items with a low probability of being assets or liabilities. (See Appendix A: Alternative Views, page 26.)

a) Do you agree with the position taken in (1) the proposed Concepts Statement or (2) the Alternative View concerning the need for an explicit requirement for an assessment of probability and a probability threshold when determining whether an item is measurable? Please explain the reasons for your position.

10. SFFAC 1, *Objectives of Federal Financial Reporting*, par. 156, states that "Financial reporting is the means of communicating with those who use financial information. For this communication to be effective, information in financial reports must have these basic characteristics: understandability, reliability, relevance, timeliness, consistency, and comparability." These six characteristics are defined in SFFAC 1 and are not altered by this Statement. Members supporting the proposed Concepts Statement do not believe that repeating the qualitative characteristics in this Statement would be useful and doing so could cause confusion regarding the status and application of the characteristics. These members believe that if the application of the characteristics requires explanation, the explanation should be approached in a comprehensive manner.

    The members expressing an alternative view point out that the proposed Concepts Statement does not include a consideration of the qualitative characteristics of financial statements as part of determining whether an item meets the recognition criteria. Members with an alternative view believe that the ED should require a consideration of all of the qualitative characteristics of financial reporting in determining whether an item meets the recognition criteria; i.e., meets the definition and is measurable. In the view of these members, the lack of a consideration of the qualitative characteristics in determining whether an item meets the recognition criteria will likely result in the recognition of items that do not meet the qualitative characteristics (e.g., not relevant or reliable.) (See Appendix A: Alternative Views, page 27.)

    a) Do you agree with the position taken in (1) the proposed Concepts Statement or (2) the Alternative View concerning the need for a consideration of the qualitative characteristics of financial statements as part of determining whether an item meets the recognition criteria? Please explain the reasons for your position.

Federal Accounting Standards Advisory Board

September 7, 2006

TO: Members of FASAB

FROM: Penny Wardlow, Consultant

THROUGH: Wendy Comes, Executive Director

SUBJECT: **Conceptual Framework: Elements.**
GASB Response to Elements ED—TAB B

NOTE: FASAB staff prepares memos and other materials to facilitate discussion of issues at Board meetings. This material is presented for discussion purposes only; it is not intended to reflect authoritative views of the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

Attached is a response from the Governmental Accounting Standards Board (GASB), which was received after the package of responses was distributed to members. Please include this letter in your package as response #40. The letter is included in the staff Summary of Responses placed at the beginning of Tab B.

GOVERNMENTAL ACCOUNTING STANDARDS BOARD
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GASB

DAVID R. BEAN
Director of Research

August 31, 2006

Ms. Wendolyn M. Comes
Executive Director
Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Washington, DC 20548

Dear Ms. Comes:

Thank you for the opportunity to offer comments on the Exposure Draft of a proposed Statement of Federal Financial Accounting Concepts, *Definition and Recognition of Elements of Accrual-Basis Financial Statements.* This response was prepared by the Governmental Accounting Standards Board's (GASB) staff. A draft of this response was provided to individual GASB members for their input. Official positions of the GASB are determined only after extensive due process and deliberation.

As the Financial Accounting Standards Advisory Board (FASAB) members and staff are aware, the GASB released in August its own Exposure Draft of a proposed Concepts Statement, *Elements of Financial Statements*. The focus of our response to the Questions for Respondents is to highlight what we perceive to be some of the differences that exist between the two proposals and why the GASB chose its course of action. We realize that the FASAB staff prepared a memo before the release of the FASAB Exposure Draft that compared the two documents at that point in time; however, we believe that a comparison from the GASB perspective may prove useful during the FASAB's redeliberations.

Question 1 (a)—Should the definitions of assets and liabilities derive from their fundamental or essential characteristics?

Response—We agree that definitions of assets and liabilities should be derived from inherent characteristics (GASB's term). Although some standards setters in the past have used other approaches, the inherent characteristics approach has proven to be more conceptually based and also provides clearer guidance for future standard setting.

Question 1 (b)—Should the definitions of net position, revenues, and expenses derive from the definitions of assets and liabilities?

Response—We do not agree that the definitions of revenues and expenses should be derived from definitions of assets and liabilities. We believe that the "derived from" approach is inherently flawed because it places emphasis, either intended or unintended, on the statement of financial position over the resource flows statement. As noted in the

Basis for Conclusion of the GASB's Elements of Financial Statements Exposure Draft, "The Board believes that these two statements [statement of financial position and resource flows statement] are of equivalent importance and that the elements of neither statement should be defined solely as changes in or residuals of elements in the other statement. For example, the Board believes that the resource flows statement should present information that can be used to assess the financial performance of government, rather than strictly presenting increases and decreases in the assets and liabilities presented in the statement of financial position."

Question 1 (c)—If an item meets the definition of an asset is it an asset even if it is not recognized in the body of a financial statement because, for example, it is not measurable or its amount is not material?

Response—We believe that if an item meets the definition of an asset it is an asset. Issues such as measurability and materiality are considerations in the recognition process.

Question 2 (a)—Are there additional elements of accrual-basis financial statements that should be defined in the Concepts Statement? If so, what are they and what are their essential characteristics? Alternatively, what are they and how would you define them?

Response—Yes. As noted in paragraphs 31-34 of the GASB's Exposure Draft, we believe that two additional financial statement elements are necessary to reflect the inherent nature of many government activities, which are period based.

The GASB has proposed an additional element—*deferred outflows of resources* that should be reported in a statement of financial position. We believe that this element should be defined as the "consumption of net resources by the entity that is applicable to a future reporting period." The GASB proposed that the inherent characteristic of being applicable to a future reporting period is parallel to the characteristic of applicable to the reporting period which is an inherent characteristic of the GASB's proposed definition of *outflows of resources* (expenses) with the exception that for a deferred outflow of resources, the outflow is applicable to a future reporting period rather than to the current reporting period.

The GASB also proposed another element—*deferred inflows of resources* that should be reported in a statement of financial position. We believe that this element should be defined as the "acquisition of net resources by the entity that is applicable to a future reporting period." The GASB proposed that the inherent characteristic of being applicable to a future reporting period is parallel to the characteristic of applicable to the reporting period which in an inherent characteristic of the GASB's proposed definition of *outflows of resources* and *inflows of resources* (revenues) with the exception that for a deferred inflow of resources, the inflow is applicable to a future reporting period rather than to the current reporting period.

Question 2 (b)—Do you agree or disagree that there are additional elements that need to be defined? If you agree, what are the essential characteristics of these elements?

Response—We do not believe that addressing items such as certain intangible resources, long-term social obligations, and other commitments require different or additional elements in accrual-basis financial statements. Although not addressed in the GASB's Exposure Draft, we do not object to items such as social benefit obligations being reported in separate statements as part of the basic financial statements. Even when obligations do not meet the definition of a liability and would not be included as a component of accrual-basis financial statements, information on those activities could be considered essential in assessing the overall economic condition and financial sustainability of a government.

Question 3—Do you agree with the position taken in (1) the proposed Concepts Statement or (2) the Alternative View concerning the potential effect of the government's ability to change laws on the recognition of a liability?

Response—The GASB addressed this issue by separating liabilities into two groups—those arising from exchange transactions and those arising from nonexchange transactions. Because exchange transactions, for the most part, are based on a legally enforceable agreement, the issue of whether the government can change the law to alter the liability is moot. For nonexchange transactions, however, circumstances are different. We recognized that the notion of legally enforceable is less clear in these circumstances. We therefore described an equivalent to legally enforceable—when *all* eligibility requirements have been met. In addition to recognizing that liabilities arise through legal obligations, the GASB's Exposure Draft also provides for the possibility that liabilities might arise in circumstances when social, moral, or economic consequences leave the entity little or no discretion to avoid a sacrifice of resources or future resources.

Question 4 (a)—Do you agree that these two characteristics are essential characteristics of all federal government assets?

Response—We agree that assets are resources that embody economic benefits or services and that control is an essential characteristic; however, we have a concern about the use of the word "can" when used in conjunction with control. We believe that the use of "can" likely will be misinterpreted to encompass future events. Given the broad range of powers afforded governments in the United States, governments "can" control many assets; however, that control can only be exercised based on some additional event occurring. We do not believe that it was the FASAB's intent to consider a resource that could be controlled as an asset. We believe that the GASB's proposed definition "Assets are resources that the entity presently controls" with adequate clarification of the terms "resources" and "control" addresses those concerns.

Question 4 (b)—Are there any *additional* characteristics that are *fundamental* or *essential* to *all* federal government assets?

Response—No. See response to 4 (a).

Question 5 (a)—Do you agree or disagree that these two characteristics are essential characteristics of all federal government liabilities?

Response—We agree with the first characteristic, present obligation; however, we believe that the second characteristic (that is, the timing of the settlement) is an aspect of the first characteristic, rather than an additional characteristic.

Question 5 (b)—Are there any *additional* characteristics that are *fundamental* or *essential* to *all* federal government liabilities?

Response—No.

Question 6 (a)—Do the definitions of assets and liabilities adequately convey the essential characteristics from which they are derived? If not, how would you modify the definitions?

Response—Respectfully, we believe that the GASB's proposed definitions more clearly capture the inherent characteristics found in the government environment in the United States.

Question 6 (b)—Do the definitions of net position, revenues, and expenses adequately convey their relationship to assets and liabilities? If not, how would you modify the definitions?

Response—As noted in the response to Question 1 (b), we believe that the definitions of revenues and expenses should be defined based on each element's own inherent characteristics. The definition of net position does adequately convey its relationship to assets and liabilities.

Question 7—Are there *other* criteria that should be established as conditions for recognition? If so, what recognition criteria would you add or delete?

Response—The GASB has only developed limited recognition criteria at a conceptual level at this point in time (project deliberations on a recognition and measurement attributes concepts project are scheduled to begin in October); therefore, it would be premature to comment at this time.

Question 8—Do you agree with the position taken in (1) the proposed Concepts Statement or (2) the Alternative View concerning the need for an explicit requirement for an assessment of probability and a related probability threshold when determining whether an item meets the definition of an element?

Response—We do not believe that there is a need for an explicit requirement for an assessment of probability and a related probability threshold when determining whether an item meets the definition of an element.

Question 9—Do you agree with the position taken in (1) the proposed Concepts Statement or (2) the Alternative View concerning the need for an explicit requirement for an assessment of probability and a probability threshold when determining whether an item is measurable?

Response—As noted in the response to Question 7, the GASB has only developed limited recognition criteria or examined measurement issues at a conceptual level at this point in time; therefore, it would be premature to comment at this time.

Question 10—Do you agree with the position taken in (1) the proposed Concepts Statement or (2) the Alternative View concerning the need for a consideration of the qualitative characteristics of financial statements as part of determining whether an item meets the recognition criteria?

Response—As previously noted the GASB has only developed limited recognition criteria at a conceptual level at this point in time; therefore, it would be premature to comment at this time.

Concluding Comment

Although both the GASB and the FASAB operate as independent bodies with individual projects and project timetables, we believe that substantive differences on issues as fundamental as financial statement elements definitions for governments in the United States should be minimized when possible. Even though both Boards have now issued proposed concepts statements, we believe that it is not too late for a meeting between the Chairmen, Directors, and project staffs to determine if a more coordinated effort has an opportunity for success.

We are willing to meet at a time and place that is convenient for the FASAB to discuss this response and the potential of working more closely together as both Elements of Financial Statements projects are finalized.

Thank you for considering our comments.

Sincerely,

David R. Bean

Federal Accounting Standards Advisory Board

September 13, 2006

TO: Members of FASAB

FROM: Penny Wardlow, Consultant

THROUGH: Wendy Comes, Executive Director

SUBJECT: **Conceptual Framework: Elements. Suggestions in the ED Responses for Certain Additional Elements: A Review of Board Decisions Incorporated Into the ED—TAB B—Paper 2**

A few respondents to the Elements Exposure Draft (ED) suggested that certain items that the Board has agreed meet the definitions of revenues or expenses should be defined as separate elements. Those items and the number of respondents who suggest them are (a) gains and losses (4 respondents), (b) appropriations (2 respondents), (c) intra-governmental transfers (3 respondents), and (d) imputed costs (1 respondent). Also, two respondents propose (e) defining unexpended appropriations and cumulative results of operations as separate elements. In its deliberations leading to the ED, the Board concluded that these items are subdivisions of net position according to a particular financial reporting model and should not be considered separate elements.

This memo reviews the Board's conclusions before issuing the ED on the items listed above. Staff recommendations follow the discussion of each item.
Staff believes this review will be useful to members who were not on the Board at the time the Board discussed the items and made the decisions, as well as a useful "refresher" for members who participated in the decisions.

(a) Gains and Losses

The Board deliberated whether gains and losses should be defined separately from revenues and expenses at the January 2006 meeting. At the same meeting the Board discussed various definitions of revenues and expenses, including the FASAB's definitions in SFFAS 7[1] (revenues) and the Consolidated Glossary (expenses); the definitions of the FASB, the GASB (tentative) and standard-setting authorities in Australia, New Zealand, Canada, the United Kingdom, and Sweden; and definitions proposed by FASAB staff for inclusion in the Elements ED.

Staff reported that the distinction between *gains* and *revenues* (or between *losses* and *expenses*) in SFFAS 7, which is a statement of standards, does not appear to be a conceptual distinction that would justify defining gains and losses as separate elements in a concepts statement. Rather, the distinction appears to relate to display considerations and, possibly, a particular financial reporting model that are appropriately addressed in standards. Paragraph 35 of SFFAS 7 states that

> When a transaction with the public or another Government entity at a price is unusual or nonrecurring, a gain or loss should be recognized rather than revenue or expense so as to differentiate such transactions.

Paragraph 35 is under the heading "Recognition and Measurement of Exchange Revenue," so that there seems little doubt that gains and losses are revenues and expenses with particular characteristics—they are unusual or nonrecurring. Further, paragraph 44 indicates that, in determining the net cost of operations of the reporting entity during the period, "The net amount of gains (or losses) should be subtracted from (or added to) gross cost to determine net cost in the same manner as exchange revenue is subtracted."

Staff also reported at the January 2006 meeting that the standard-setting authorities in Australia, New Zealand, and Sweden do not define gains and losses separately in their concepts statements. Also, the UK board defines gains and losses and explains that the definitions include "items that are often referred to as 'revenue' and expenses'."[2] The Australian Boards explain their decision as follows:[3]

> The defining of gains and losses separately from revenues and expenses was formally considered by the AASB and PSASB . . . The approach was not supported by the Boards, primarily because of the difficulties of consistently distinguishing inflows and outflows from "ordinary" or "central" operations (such as production or sale of inventories, rendering of services and the provision of finance) from inflows and outflows (such as purchase of plant, collections from debtors and receipt of borrowings) which are not "central" but nevertheless are often essential to the operations of the entity. *Being a matter of display, the presentation of revenues and expenses jointly as "gains" and "losses" is compatible with the concepts in this*

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[1] Statement of Federal Financial Accounting Standards No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting* (issued May 10, 1996)

[2] Statement of Principles for Financial Reporting—Proposed Interpretation for Public Benefit Entities, Chapter 4, par. 4.49.

[3] Statement of Accounting Concepts No. 4, *Definition and Recognition of the Elements of Financial Statements* (1995), Background and Basis for Conclusions, par. A15, italics added.

Statement. This display issue will be the subject of a Statement of Accounting Concepts on the display of performance.

The FASB and CICA (Canada) define gains and losses separately in, respectively, Concepts Statement 6 and the CICA Handbook, which addresses accounting principles as well as concepts. The FASB indicates that both revenues/expenses and gains/losses are inflows/outflows of resources. The distinction the boards make that revenues/expenses result from "ongoing major or central operations" whereas gains/losses result from "peripheral or incidental transactions." However, the FASB indicates in the Basis for Conclusions to Concepts Statement 6 that the Board's focus was on the usefulness of separate display within a particular reporting model rather than on conceptual differences:

> Since a primary purpose of distinguishing gains and losses from revenues and expenses is to make displays of information about an enterprise's sources of comprehensive income as useful as possible, fine distinctions between revenues and gains and between expenses and losses are principally matters of display or reporting (par. 89).

The FASB also acknowledges that one of the difficulties with adopting a distinction between revenues and gains and between expenses and losses is the difficulty of generalizing the distinction to all entities:

> . . . Distinctions between revenues and gains and between expenses and losses in a particular entity depend to a significant extent on the nature of the entity, its operations, and its other activities. Items that are revenues for one kind of entity may be gains for another, and items that are expenses for one kind of entity may be losses for another. . . (par. 88)

This raises the question whether it is appropriate or feasible to develop entity-specific definitions for a concepts statement.

The CICA Handbook states that gains and losses arise from peripheral or incidental transactions. However, its definition of expenses states that expenses include losses. The Swedish board (for government accounting standards) also states specifically that the definition of expenses and revenues include, respectively, the concepts of loss and gain.

In the memo to the Board for the January 2006 meeting, staff recommended:

> . . . that the FASAB should not include definitions of gains and losses in the concepts statement on elements. Rather, consistent with SFFAS 7, other standard setters' views, and practice, gains and losses should be considered particular kinds of revenues and expenses—subsets or sub-elements, rather than separate elements. Certain revenues and expenses may be separately displayed as gains and losses, as required by a statement of standards, but they are not conceptually distinct elements that should be defined in a concepts statement on elements. If the Board decided to include definitions of gains and losses in the concepts statement on elements, then what would be the explanation for defining subsets of revenues and expenses but not

defining subsets of assets, such as capital assets and financial assets, or subsets of liabilities, such as current and noncurrent liabilities? . . .

The Board agreed as indicated in this excerpt from the Minutes of the January 2006 meeting:

> The [staff] memo also recommended that gains and losses should not be treated as separate elements in the concepts statement but should be considered sub-elements or subsets of revenues and expenses. The Board agreed and concluded that whether and under what circumstances certain items should be reported as gains and losses instead of revenues and expenses is a display issue and should be addressed in financial reporting standards.

As a result of the Board's decision, the Elements ED has the following two paragraphs on gains and losses in the section on "Definitions of Revenue and Expense":

55. Existing standards or established practice may indicate that certain inflows and outflows of resources should be reported as gains and losses, rather than revenues and expenses. Use of the terms gains and losses generally serves to highlight particular features of certain revenues and expenses, such as their unusual or non-recurring nature[9]or their having resulted from peripheral or incidental activities of an entity.[10]

56. The definitions of revenue and expense in this Statement include items that might be reported as gains and losses. Gains and losses are considered subsets of revenues and expenses, rather than distinct elements, just as capital assets and financial assets are considered subsets of assets. Whether certain kinds of revenues and expenses should be reported as gains and losses and, if so, under what circumstances, is beyond the scope of this Concepts Statement.

[9]See, for example, Statement of Federal Financial Reporting Standards No. 7, Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting, par. 35 (FASAB, 1996)
[10]The latter distinction is included in FASB Concepts Statement No. 6, Elements of Financial Statements, par. 87 (FASB, 1985)

Staff Recommendation: The Board should reaffirm its decision that gains and losses are sub-sets of revenues and expenses and should not be defined as separate elements. In staff's view, the responses do not contain anything the Board has not discussed or a compelling reason to change the ED proposal. The four respondents who suggested defining gains and losses either gave reasons grounded in current practice and display standards (in one case: 031—non-federal other, standards of another country; 035—federal auditor (made reference to FASB Concepts Statement 6 and SFFAS 7); and 039—non-federal other (gains and losses are not reported as revenues and expenses, and they are reported net); or the respondent did not give a reason (028—federal preparer).

(b) Appropriations

The Board also discussed at the January 2006 meeting whether appropriations should be considered revenues. SFFAS 7 defines appropriations and transfers as other financing sources, rather than revenues. However, the standard states that other financing sources are inflows of resources like revenues. Staff suggested that, as with gains and losses, the distinction between other financing sources and revenues could be one of display rather than a conceptual distinction. Staff noted that in practice, many entities regard appropriations as revenues, regardless of whether they are referred to as other financing sources in certain statements. Staff recommended that the definition of revenue in the forthcoming concepts statement on Elements should specifically include appropriations.

The Board discussed the issue and concluded that appropriations are "like revenues" for component entities but not for the government as a whole. The decision is recorded as follows in the Minutes of the January 2006 meeting:

> **Appropriations**
> The Board discussed the nature and role of appropriations and generally agreed with Mr. Jacobson's and Mr. Reid's view that appropriations are revenues of component entities but not of the government as a whole. Consequently, because the definitions of all elements in the proposed concepts statement apply to both agency financial statements and the consolidated financial report (CFR), the Board agreed that appropriations should not be included in the definition of revenues. In addition, the word "entity" should replace "federal government" in the definition of revenue to avoid potential misinterpretations that appropriations are revenue of the government as a whole. The Board decided to include a brief explanation of appropriations in paragraph 14, which covers elements that are recognized in agency financial statements but not in the CFR. Mr. Reid said that the explanation also should cover fund balance with treasury, because it includes primarily unspent appropriations. Mr. Jacobson agreed to assist Ms. Wardlow with appropriate wording for paragraph 14.

As a result of that decision, the Elements ED includes the following paragraph that discusses appropriations:

> 15. Appropriations are another example of items reported in the accrual-basis financial statements of component entities but not in the consolidated financial statements of the federal government. For the component entities, appropriations are inflows of resources against which the component entity may incur obligations in support of authorized activities. Assuming compliance with the relevant definitions of elements and the recognition criteria, a component entity would recognize appropriations as increases in assets and revenues and would recognize the use of appropriations as increases in expenses and decreases in fund balance with Treasury. However, from the perspective of the government as a whole, an appropriation is not a resource flow to the federal government or from the government to a component entity. Rather, it is a budgetary amount that constitutes legal authority for a component entity to incur obligations for specified purposes during specified time periods, and for the U.S. Treasury to liquidate the resulting obligations of the component entity. The actual liquidation will be from cash and other assets of the U.S. Treasury resulting from the inflow of resources from taxes and other financing sources. Therefore, appropriations recognized by component entities are eliminated in the process of consolidation and are not reported in the consolidated financial statements of the federal government.

Staff Recommendation: The Board should reaffirm its decision that appropriations are revenues of component entities but not of the government as a whole. In staff's view, the responses are not persuasive. One respondent (026—non-federal other) does not give a reason for its suggestion; the other respondent (029—federal preparer) states that appropriations and other items proposed (including those in sections (c) and (e) below) "are unique elements of our statements that warrant separate definitions in the overall context of the Concepts Statement."

(c) Intra-governmental Transfers

In the staff memo for the January 2006 meeting, staff reported that, in addition to appropriations, SFFAS 7 defines transfers as other financing sources, rather than revenues. However, as noted in the previous section, the standard states that other financing sources are inflows of resources like revenues. Staff also reported at the January meeting that there is no explanation in SFFAS 7 of why intra-governmental transfers should be excluded from the definitions of revenues and expenses. As with appropriations, transfers would not be revenues of the government as a whole.

At the January meeting, the Board did not disagree with staff's recommendation that transfers should be included in the definitions of revenues and expenses in the forthcoming concepts statement. This issue is not included in the Minutes of the January 2006 meeting. Transfers are not specifically mentioned in the Elements ED.

Staff Recommendation: Staff recommends that the Board reaffirm its decision. Staff does not find in the responses a compelling reason for change. Respondent No. 022—Non-federal other indicates that "transfer" elements would avoid eliminations in consolidating financial statements and suggests that transfers be defined as "increases and/or decreases in assets and/or liabilities exchanged between component units of the federal government." Respondent No. 026—Non-federal other does not give a reason. Respondent No. 029—federal preparer gave the statement about "unique elements" reported for gains and losses above.

(d) Imputed Costs

The Board briefly discussed whether imputed costs are included in the definition of expenses. Staff believes that the Board agreed that such costs should be included in the definition of expenses for component entities. Staff observes that Interpretation No. 6[4] states the following:

> 11. Imputed intra-departmental costs are the unreimbursed portion of the full costs of goods and services received by the entity from a providing entity that is part of the same department or larger reporting entity (i.e. other bureaus, components or responsibility segments within the department or larger reporting entity).

[4] Interpretation No. 6, *Accounting for Imputed Intra-departmental Costs: An Interpretation of SFFAS No. 4* [Managerial Cost Accounting Standards and Concepts],

Staff Recommendation: Staff recommends that the Board reaffirm its decision. Staff does not find in the responses a compelling reason for change. Respondent No. 011—Non-federal other, the only respondent to suggest defining imputed costs as a separate element, states that items unique to federal reporting, such as imputed costs, should be defined.

(e) Unexpended Appropriations and Cumulative Results of Operations

At the August 2005 meeting, the Board discussed whether net position should be defined in the forthcoming concepts statement on Elements and, if so, whether definitions also should be provided of its components, unexpended appropriations and cumulative results of operations. One of the issues discussed was a concern that defining the components of net position would imply that the definitions in the concepts statement apply to a particular financial reporting model. The Board had previously decided that the concepts statement should not be restricted to the current reporting model. The Board agreed to define net position simply as the difference between assets and liabilities and not to define any components of net position.

Staff Recommendation: The Board should reaffirm its decision that components of net position should not be defined as elements. In staff's view, the responses are not persuasive. One respondent (026—non-federal other) does not give a reason for its suggestion; the other respondent (029—federal preparer) states that these and other items proposed (including those in sections (b) and (c) above) "are unique elements of our statements that warrant separate definitions in the overall context of the Concepts Statement."

Conclusion: Staff recommends that the Board should not change its decision on the items discussed in this memo: (a) gains and losses, (b) appropriations, (c) intra-governmental transfers, (d) imputed costs, and (e) unexpended appropriations and cumulative results of operations. Although very few respondents to the ED have made these suggestions, the staff recommendations are not intended to preclude a brief discussion of the Board's reasons for its decisions on these items in the basis for conclusions to the final concepts statement and/or a clarification in the text, if the Board believes one or both explanations are needed.

Staff will prepare papers on issues raised in the responses to the Elements ED for future meetings, beginning with the November 2006 meeting.